Charities in Crisis

'Governance', 'Reporting', 'Accountability' are the watchwords for 2011

By Teresa Harrington, FCA

Reduced funding, diminishing donations, and increased scrutiny are just some of the challenges facing charities. In this difficult climate, good planning has never been more important, explains Teresa Harrington.

The turbulent economic climate has put an unprecedented amount of pressure on charities. Tougher economic times have resulted in significant cuts in statutory funding, reduced donations from the public and a sharp rise in the demand for the services that charities provide. The charity sector is also being called on to play increasing role in delivering public services. At the same time, charities are under intense scrutiny internally and by the public and must be increasingly transparent and cost-effective. They face significant strategic and operational challenges to improve efficiencies and demonstrate value-for-money and while delivering high quality services. More and more charities will find it difficult to continue to operate in this environment. Good governance, accountability and clear and concise reporting will be critical to survival.

Warning signs

Charity trustees and managers need to be alert for warning signs such as:

- *Significant reliance on one source of funding*
  Government sponsors, either through core funding or grants, are a large part of the voluntary sector. We have seen much 'belt tightening' over the past two years and more is to come. Charities will continue to suffer reduced funding from Government.
- *Reliance on restricted funding*
  Charities are finding it difficult to operate in a quasi-commercial way with funders only interested in providing funds to cover direct costs and not overheads.
- *Governance and reporting*
  Charities are finding it difficult to recruit quality trustees with concerns of solvency and survival on many peoples' minds. Limited management information may make the prediction of changes in income and costs difficult thus leading to weak governance. Charities may enter into contracts or projects that are not properly costed and be drawn into attempting to deliver services for less than the cost of delivery.

Strategies to cope with reduced income

Now, more than ever, there is a need to plan – to get your strategy right, manage risk and work smarter. Charities need to set priorities and explore all options to reduce costs and maintain services.

It is likely that market forces and increased public scrutiny will result in more collaboration and we are likely to see a number of mergers in the sector. Reduced income will threaten the level of service that some charities offer while for others it will threaten their very existence. Many charities are too small to benefit from a critical mass that would enable them to function efficiently and to leverage the buying power that size could afford them.

Are there too many charities in Ireland?

There is currently no register of charities in Ireland, however there are circa 7,800 organisations listed on the Revenue Commissioners' website as having been granted charitable tax exemption. With so many charities, the question arises as to whether there is too much duplication and competition for funds. There are many benefits to be realised from collaboration or merger with another charity. Frequently, obstacles such as the perceived loss of independence in decision making, or dilution of a brand, are cited as reasons not to merge. These concerns need to be addressed. Trustees should question whether it continues to be appropriate for the organisation to remain as a stand-alone entity over the next few years.

Governance

Governance and reporting were never more important. Inadequate information for decision making may lead to the demise of a charity. As in all businesses, trustees must have good quality management information on which to base decisions and so as to react quickly to critical funding situations. This can only be achieved with access to regular and reliable financial and operational information that is reported on frequently.

Charities need to review their management information systems and ensure that there is a proper audit trail for all transactions, that income and costs are recognised in the correct period, that assets are carried at appropriate values in the balance sheet and that all liabilities are recognised.

An over-reliance on spreadsheets can result in poor management information. Management accounts with appropriate details of activities, including key performance indicators, should form part of the management reporting pack. There should be a focus on cash flows and regular monitoring of the income and expenditure account and balance sheet. Trustees should query and challenge assumptions, especially in cash strapped charities that are taking on new projects.

Board induction

Today, potential trustees of charities are more aware of their duties than in the past. These duties are set out in the Charities Act 2009 (the Act) (sections of which are not yet commenced). Board induction days will be more important.The agenda for these meetings should include:

- Background and introduction to the charity;
- Understanding the charity's governing document;
- Understanding the charitable purpose and the needs of beneficiaries;
- Understanding the risks that the charity needs to address;
- Understanding the annual report, financial statements and the monthly reporting pack.

The Act provides for the establishment of a Charity Regulatory Authority (CRA) and for the appointment of a Regulator. Charities will be required to register with and submit annual reports and accounts to the CRA. The form and content of these will be determined by the Minister, however it is widely anticipated that it will follow that adopted in the UK and set out in the *Statement of Recommended Practice – Accounting and Reporting by Charities* (SORP) (revised 2005).

Irish charities, in the absence of regulations governing their financial

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Too many charities in a small marketplace leads to duplication and competition for scarce funds.

reporting requirements, should consider the requirements of the SORP as best practice reporting and follow it in the preparation of their financial statements.

In tandem with the change in charity law in Ireland, *Accountancy Ireland* readers will be aware that the nature of UK and Irish GAAP is changing. In August 2009, the Accounting Standards Board (ASB) issued a consultation paper entitled, *The Future of UK GAAP*, and requested comment on the policy proposal. At the time of writing we await the publication of the Financial Reporting Exposure Draft (FRED) for Public Benefit Entities (PBE) which will be completed in 2011. The ASB is proposing that the PBE standard will be a 'differences only' standard – identifying where there are omissions from UK financial reporting standards that need to be addressed for PBEs. Charities are a component part of the PBE sector. The ASB also recognises that there is an ongoing role for the development of guidance by the sector in the form of SORPs.

The Charities Act 2009, signed into law on 28 February 2009, sets out trustees' duties in relation to governance, accounting and reporting. While many sections of the Act have not yet commenced, trustees, management, staff and advisors should be aware of the requirements and begin to prepare for compliance.

The year ahead will be one of challenge and change for charities. Trustees need to plan now for the future. Good quality financial and operational information will be critical to enable this planning process to be effective. Charities need to review their strategy with a particular focus on the needs they serve and the most cost effective ways of serving the best interests of their beneficiaries. Charities should also actively challenge their need to exist – consider mergers, or, at a minimum collaborate. the most cost effective ways of serving the best interests of their beneficiaries. Charities should also actively challenge their need to exist and consider mergers, or, at a minimum collaborate.

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